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include payment of the required user fee.

[T.D. 8540, 59 FR 30173, June 10, 1994, as amended at 59 FR 30173, 30174, June 10, 1994; T.D. 8819, 64 FR 23226, Apr. 30, 1999; T.D. 8886, 65 FR 36943, June 12, 2000]

DEDUCTIONS

§ 25.2519–1 Dispositions of certain life estates.

(a) *In general.* If a donee spouse makes a disposition of all or part of a qualifying income interest for life in any property for which a deduction was allowed under section 2056(b)(7) or section 2523(f) for the transfer creating the qualifying income interest, the donee spouse is treated for purposes of chapters 11 and 12 of subtitle B of the Internal Revenue Code as transferring all interests in property other than the qualifying income interest. For example, if the donee spouse makes a disposition of part of a qualifying income interest for life in trust corpus, the spouse is treated under section 2519 as making a transfer subject to chapters 11 and 12 of the entire trust other than the qualifying income interest for life. Therefore, the donee spouse is treated as making a gift under section 2519 of the entire trust less the qualifying income interest, and is treated for purposes of section 2036 as having transferred the entire trust corpus, including that portion of the trust corpus from which the retained income interest is payable. A transfer of all or a portion of the income interest of the spouse is a transfer by the spouse under section 2511. See also section 2702 for special rules applicable in valuing the gift made by the spouse under section 2519.

(b) *Presumption.* Unless the donee spouse establishes to the contrary, section 2519 applies to the entire trust at the time of the disposition. If a deduction is taken on either the estate or gift tax return with respect to the transfer which created the qualifying income interest, it is presumed that the deduction was allowed for purposes of section 2519. To avoid the application of section 2519 upon a transfer of all or part of the donee spouse's income interest, the donee spouse must establish that a deduction was not taken for the transfer of property which created the qualifying income interest. For example, to establish that a deduction was not taken, the donee spouse may produce a copy of the estate or gift tax return filed with respect to the transfer creating the qualifying income interest for life establishing that no deduction was taken under section 2056(b)(7) or section 2523(f). In addition, the donee spouse may establish that no return was filed on the original transfer by the donor spouse because the value of the first spouse's gross estate was below the threshold requirement for filing under section 6018. Similarly, the donee spouse could establish that the transfer creating the qualifying income interest for life was made before the effective date of section 2056(b)(7) or section 2523(f), whichever is applicable.

(c) *Amount treated as a transfer*—(1) *In general.* The amount treated as a transfer under this section upon a disposition of all or part of a qualifying income interest for life in qualified terminable interest property is equal to the fair market value of the entire property subject to the qualifying income interest, determined on the date of the disposition (including any accumulated income and not reduced by any amount excluded from total gifts under section 2503(b) with respect to the transfer creating the interest), less the value of the qualifying income interest in the property on the date of the disposition. The gift tax consequences of the disposition of the qualifying income interest are determined separately under § 25.2511–2. See paragraph (c)(4) of this section for the effect of gift tax that the donee spouse is entitled to recover under section 2207A.

(2) *Disposition of interest in property with respect to which a partial election was made.* If, in connection with the transfer of property that created the spouse's qualifying income interest for life, a deduction was allowed under section 2056(b)(7) or section 2523(f) for less than the entire interest in the property (i.e., for a fractional or percentage share of the entire interest in the transferred property) the amount treated as a transfer by the donee spouse under this section is equal to

the fair market value of the entire property subject to the qualifying income interest on the date of the disposition, less the value of the qualifying income interest for life, multiplied by the fractional or percentage share of the interest for which the deduction was taken.

(3) *Reduction for distributions charged to nonelective portion of trust.* The amount determined under paragraph (c)(2) of this section (if applicable) is appropriately reduced if—

(i) The donee spouse's interest is in a trust and distributions of principal have been made to the donee spouse;

(ii) The trust provides that distributions of principal are made first from the qualified terminable interest share of the trust; and

(iii) The donee spouse establishes the reduction in that share based on the fair market value of the trust assets at the time of each distribution.

(4) *Effect of gift tax entitled to be recovered under section 2207A on the amount of the transfer.* The amount treated as a transfer under paragraph (c)(1) of this section is further reduced by the amount the donee spouse is entitled to recover under section 2207A(b) (relating to the right to recover gift tax attributable to the remainder interest). If the donee spouse is entitled to recover gift tax under section 2207A(b), the amount of gift tax recoverable and the value of the remainder interest treated as transferred under section 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under § 25.2207A–1(b).

(5) *Interest in previously severed trust.* If the donee spouse's interest is in a trust consisting of only qualified terminable interest property, and the trust was previously severed (in compliance with § 20.2056(b)–7(b)(2)(ii) of this chapter or § 25.2523(f)–1(b)(3)(ii) from a trust that, after the severance, held only property that was not qualified terminable interest property, only the value of the property in the severed portion of the trust at the time of the disposition is treated as transferred under this section.

(d) *Identification of property transferred.* If only part of the property in which a donee spouse has a qualifying income interest for life is qualified terminable interest property, the donee spouse is, in the case of a disposition of all or part of the income interest within the meaning of section 2519, deemed to have transferred a pro rata portion of the entire qualified terminable interest property for purposes of this section.

(e) *Exercise of power of appointment.* The exercise by any person of a power to appoint qualified terminable interest property to the donee spouse is not treated as a disposition under section 2519, even though the donee spouse subsequently disposes of the appointed property.

(f) *Conversion of qualified terminable interest property.* The conversion of qualified terminable interest property into other property in which the donee spouse has a qualifying income interest for life is not, for purposes of this section, treated as a disposition of the qualifying income interest. Thus, the sale and reinvestment of assets of a trust holding qualified terminable interest property is not a disposition of the qualifying income interest, provided that the donee spouse continues to have a qualifying income interest for life in the trust after the sale and reinvestment. Similarly, the sale of real property in which the spouse possesses a legal life estate and thus meets the requirements of qualified terminable interest property, followed by the transfer of the proceeds into a trust which also meets the requirements of qualified terminable interest property, or by the reinvestment of the proceeds in income producing property in which the donee spouse has a qualifying income interest for life, is not considered a disposition of the qualifying income interest. On the other hand, the sale of qualified terminable interest property, followed by the payment to the donee spouse of a portion of the proceeds equal to the value of the donee spouse's income interest, is considered a disposition of the qualifying income interest.

(g) *Examples.* The following examples illustrate the application of paragraphs (a) through (f) of this section. Except

as provided otherwise in the examples, assume that the decedent, D, was survived by spouse, S, that in each example the section 2503(b) exclusion has already been fully utilized for each year with respect to the donee in question, that section 2503(e) is not applicable to the amount deemed transferred, and that the gift taxes on the amount treated as transferred under paragraph (c) are offset by S's unified credit. The examples are as follows:

Example 1. Transfer of the spouse's life estate in residence. Under D's will, a personal residence valued for estate tax purposes at $250,000 passes to S for life, and after S's death to D's children. D's executor made a valid election to treat the property as qualified terminable interest property. During 1995, when the fair market value of the property is $300,000 and the value of S's life interest in the property is $100,000, S makes a gift of S's entire interest in the property to D's children. Pursuant to section 2519, S makes a gift in the amount of $200,000 (i.e., the fair market value of the qualified terminable interest property of $300,000 less the fair market value of S's qualifying income interest in the property of $100,000). In addition, under section 2511, S makes a gift of $100,000 (i.e., the fair market value of S's income interest in the property). See § 25.2511–2.

Example 2. Sale of spouse's life estate. The facts are the same as in *Example 1* except that during 1995, S sells S's interest in the property to D's children for $100,000. Pursuant to section 2519, S makes a gift of $200,000 ($300,000 less $100,000 value of the qualifying income interest in the property). S does not make a gift of the income interest under section 2511, because the consideration received for S's income interest is equal to the value of the income interest.

Example 3. Transfer of income interest in trust subject to partial election. D's will established a trust valued for estate tax purposes at $500,000, all of the income of which is payable annually to S for life. After S's death, the principal of the trust is to be distributed to D's children. Assume that only 50 percent of the trust was treated as qualified terminable interest property. During 1995, S makes a gift of all of S's interest in the trust to D's children at which time the fair market value of the trust is $400,000 and the fair market value of S's life income interest in the trust is $100,000. Pursuant to section 2519, S makes a gift of $150,000 (the fair market value of the qualified terminable interest property, 50 percent of $400,000, less the $50,000 income interest in the qualified terminable interest property). S also makes a gift pursuant to section 2511 of $100,000 (i.e., the fair market value of S's life income interest).

Example 4. Transfer of a portion of income interest in trust subject to a partial election. The facts are the same as in *Example 3* except that S makes a gift of only 40 percent of S's interest in the trust. Pursuant to section 2519, S makes a gift of $150,000 (i.e., the fair market value of the qualified terminable interest property, 50 percent of $400,000, less the $50,000 value of S's qualified income interest in the qualified terminable interest property). S also makes a gift pursuant to section 2511 of $40,000 (i.e., the fair market value of 40 percent of S's life income interest). See also section 2702 for additional rules that may affect the value of the total amount of S's gift under section 2519 to take into account the fact that S's 30 percent retained income interest attributable to the qualifying income interest is valued at zero under that section, thereby increasing the value of S's section 2519 gift to $180,000. In addition, under § 25.2519–1(d), S's disposition of 40 percent of the income interest is deemed to be a transfer of a pro rata portion of the qualified terminable interest property. Thus, assuming no further lifetime dispositions by S, 30 percent (60 percent of 50 percent) of the trust property is included in S's gross estate under section 2036 and an adjustment is made to S's adjusted taxable gifts under section 2001(b)(1)(B). If S later disposes of all or a portion of the retained income interest, see § 25.2702–6.

Example 5. Transfer of a portion of spouse's interest in a trust from which corpus was previously distributed to the spouse. D's will established a trust valued for estate tax purposes at $500,000, all of the income of which is payable annually to S for life. The trustee is granted the discretion to distribute trust principal to S. All appointments of principal must be made from the portion of the trust subject to the section 2056(b)(7) election. After S's death, the principal of the trust is to be distributed to D's children. The executor makes the section 2056(b)(7) election with respect to 50 percent of the trust. In 1994, pursuant to the terms of D's will, the trustee distributed $50,000 of principal to S and charged the entire distribution to the qualified terminable interest portion of the trust.

Immediately prior to the distribution, the value of the entire trust was $550,000 and the value of the qualified terminable interest portion was $275,000 (50 percent of $550,000). Provided S can establish the above facts, the qualified terminable interest portion of the trust immediately after the distribution is $225,000 or 45 percent of the value of the trust ($225,000/$500,000). In 1996, when the value of the trust is $400,000 and the value of S's income interest is $100,000, S makes a transfer of 40 percent of S's income interest. S's gift under section 2519 is $135,000; i.e., the fair market value of the qualified terminable interest property, 45 percent of $400,000

($180,000), less the value of the income interest in the qualified terminable interest property, $45,000 (45 percent of $100,000). S also makes a gift under section 2511 of $40,000; i.e., the fair market value of 40 percent of S's income interest. S's disposition of 40 percent of the income interest is deemed to be a transfer under section 2519 of the entire 45 percent portion of the remainder subject to the section 2056(b)(7) election. Since S retained 60 percent of the income interest, 27 percent (60 percent of 45 percent) of the trust property is includible in S's gross estate under section 2036. See also section 2702 and *Example 4* as to the principles applicable in valuing S's gift under section 2702 and adjusted taxable gifts upon S's subsequent death.

Example 6. Transfer of Spousal Annuity Payable From Trust. D died prior to October 24, 1992. D's will established a trust valued for estate tax purposes at $500,000. The trust instrument required the trustee to pay an annuity to S of $20,000 a year for life. All the trust income other than the amounts paid to S as an annuity are to be accumulated in the trust and may not be distributed during S's lifetime to any person other than S. After S's death, the principal of the trust is to be distributed to D's children. Because D died prior to the effective date of section 1941 of the Energy Policy Act of 1992, S's annuity interest qualifies as a qualifying income interest for life. Under §20.2056(b)–7(e) of this chapter, based on an applicable 10 percent interest rate, 40 percent of the property, or $200,000, is the value of the deductible interest. During 1996, S makes a gift of the annuity interest to D's children at which time the fair market value of the trust is $800,000 and the fair market value of S's annuity interest in the trust is $100,000. Pursuant to section 2519, S is treated as making a gift of $220,000 (the fair market value of the qualified terminable interest property, 40 percent of $800,000 ($320,000), less the $100,000 annuity interest in the qualified terminable interest property). S is also treated pursuant to section 2511 as making a gift of $100,000 (the fair market value of S's annuity interest).

[T.D. 8522, 59 FR 9656, Mar. 1, 1994, as amended by T.D. 9077, 68 FR 42595, July 18, 2003]

§ 25.2519–2 Effective date.

Except as specifically provided in §25.2519–1(g), *Example 6*, the provisions of §25.2519–1 are effective with respect to gifts made after March 1, 1994. With respect to gifts made on or before such date, the donee spouse of a section 2056(b)(7) or section 2523(f) transfer may rely on any reasonable interpretation of the statutory provisions. For these purposes, the provisions of §25.2519–1 (as well as project LR–211–76, 1984–1 C.B., page 598, see §601.601(d)(2)(ii)(*b*) of this chapter), are considered a reasonable interpretation of the statutory provisions.

[T.D. 8522, 59 FR 9658, Mar. 1, 1994]

§ 25.2521–1 Specific exemption.

(a) In determining the amount of taxable gifts for the calendar quarter (calendar year with respect to gifts made before January 1, 1971) there may be deducted, if the donor was a resident or citizen of the United States at the time the gifts were made, a specific exemption of $30,000, less the sum of the amounts claimed and allowed as an exemption in prior calendar quarters or calendar years. The exemption, at the option of the donor, may be taken in the full amount of $30,000 in a single calendar quarter or calendar year, or be spread over a period of time in such amounts as the donor sees fit, but after the limit has been reached no further exemption is allowable. Except as otherwise provided in a tax convention between the United States and another country, a donor who was a nonresident not a citizen of the United States at the time the gift or gifts were made is not entitled to this exemption. For the definition of calendar quarter see §25.2502–1(c)(1).

(b) No part of a donor's lifetime specific exemption of $30,000 may be deducted from the value of a gift attributable to his spouse where a husband and wife consent, under the provisions of section 2513, to have the gifts made during a calendar quarter or calendar year considered as made one-half by each of them. The ''gift-splitting'' provisions of section 2513 do not authorize the filing of a joint gift tax return nor permit a donor to claim any of his spouse's specific exemption. For example, if a husband has no specific exemption remaining available, but his wife does, and the husband makes a gift to which his wife consents under the provisions of section 2513, the specific exemption remaining available may be claimed only on the return of the wife with respect to one-half of the gift. The husband may not claim any specific exemption since he has none available.

(c)(1) With respect to gifts made after December 31, 1970, the amount by